

# THE BOND BUYER

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## Tax Revenue Drops Could Hurt Ratings, Lead to More Debt

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By [Audrey Dutton](#)

State sales and income tax revenue took a nosedive in the third quarter of fiscal 2008 and will likely worsen during the first half of 2009, possibly threatening states' ratings and forcing them to issue more short-term debt, warned a report issued Friday by the Nelson A. Rockefeller Institute of Government.

Local governments maintained relatively stable tax revenue toward the end of fiscal 2008 partly due to their heavy reliance on property taxes, the report said. But those localities are seeing a downward trend in their tax collections.

"The preliminary data for the fourth quarter is very bad, and I'm sure a lot of governments will be caught in a painful surprise," Donald Boyd, a senior fellow at the institute, said in an interview.

Total tax collections for states dropped by more than 4% during the opening months of the fourth quarter compared to the same period a year earlier, the report concluded based on quarterly tax data from the Census Bureau.

The forecast "certainly increases the chance of issuance of short-term debt, cash-flow borrowing" by states, Boyd said.

States could suffer collateral damage from the sharply declining income and sales tax revenue, he said - they could face rating problems if the tax losses cause state budget gaps to widen.

State budget officers see the revenue drop as further evidence to support their push for federal aid in the forthcoming stimulus package.

States with major drops in revenue might need to either raise taxes or cut budgets, or both, said Scott Pattison, executive director of the National Association of State Budget Officers. Such actions could have an "anti-stimulative or negative economic effect," he said, but federal lawmakers could help ameliorate that effect by providing states with funding for Medicaid, education, or other programs.

"Federal government assistance can help temper the pain of what states are going to have to do," Pattison said.

The Rockefeller Institute found that, during the July to September quarter of 2008, states seemed to take in 3.2% more tax dollars than during the same period in 2007, and that local taxes appeared to jump by "a surprisingly strong" 5.6%, thanks mostly to a 7.3% growth in property taxes. However, those numbers "require careful interpretation," the report said.

Taking into account inflation, legislative changes, among other factors, the institute found that tax revenue during the third quarter actually declined in 29 states. Most of the states in the report were hit with declining sales and personal income tax revenue for the opening months of the final quarter of 2008.

"The Southeast was the weakest region in the third quarter, while the mid-Atlantic region now appears

on the cusp of significant declines," it warned.

Year-over-year growth in state tax revenues slowed to 0.6% on average over the last four quarters, from 4.5% two years ago, the report said. On the local level, year-over-year growth in tax revenue was down to 1.8% over the last four quarters, compared with 3.7% a year ago.

Most of the overall growth in state taxes during the third quarter were due to quadrupled tax revenue in Alaska, the institute found.

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